

ADMINISTRATIVE-INTERNAL USE ONLY

24 August 1977

MEMORANDUM

SUBJECT : Talking Points for DCI Meeting with the
Military-Economic Advisory Panel (MEAP),
1500, 29 August 1977

1. You last met with the MEAP on 19 May. At that meeting you appointed Dr. K. Wayne Smith Chairman, vice Dr. Herbert S. Levine. During the substantive discussion you asked the Panel to look into three issues:

- The priority of economic intelligence.
- Collection priority with regard to overt sources of information.
- The proper role of intelligence in the public arena.

You then requested that the Panel report its findings to you in August. You also informed the Panel that all CIA advisory panels are under review, and that after reading the MEAP's report you would have a better idea about its future status.

2. Dr. Smith scheduled the 29 August meeting to discuss the Panel's written report, dated 11 August, as well as the Panel's future. The Panel report addresses the issues you raised. In addition, it:

- Reviews the history of the MEAP.
- Summarizes past MEAP recommendations and the extent to which they have been implemented.

ADMINISTRATIVE-INTERNAL USE ONLY

- Gives the Panel's perception of shortcomings in the analytical process and suggests remedies.

3. The MEAP principal concerns are that the Community:

- Is not giving adequate attention to future requirements for analytical resources.
- Has, over time, reduced the level of basic research on the Soviet Union.
- Lacks a workable organizational solution for integrating specialized Soviet studies to provide balanced assessments of Soviet motives, plans, and capabilities.
- Places disproportionate emphasis on technical collection relative to human and documentary sources.

4. The Panel members especially want to discuss concerns they have about the role of intelligence in the public arena. During that discussion you might want to raise the following points:

- In going public with estimates, we may damage our credibility because we cannot openly defend judgments based on sensitive sources. What criteria should we use to establish a policy on releasing estimates and to minimize this problem?
- Experience shows that when we publicly release intelligence judgments on questions of continuing concern, we are often pressured to provide frequent updates. This dissipates analytical resources and reduces our ability to do the kind of in-depth research that the Panel urges. Can we successfully resist such pressure?

Attachment:
MEAP Report

SUBJECT: Talking Points for DCI Meeting with the
Military-Economic Advisory Panel (MEAP),
1500, 29 August 1977

Distribution:

Orig. & 1 -- Addressee (w/att.)
1 -- ADDCI (w/att.)
1 -- ADDI
1 -- ER
2 -- D/OSR
1 -- ME (MEAP)

STAT

OSR/MEAC/[] (24 August 1977)

MEMORANDUM FOR: Director, OSR

STAT

ATTENTION:

Mark,

Per Executive Secretary's note, please prepare a background piece for the Director to review prior to the 29 August meeting.

Please provide by COB 23 August.

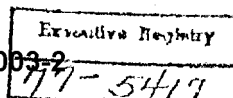
STAT

Special Assistant/DDI

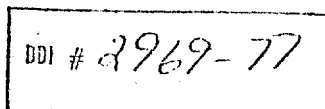
12 Aug 77

Date

FORM 101 USE PREVIOUS
5-75 EDITIONS



11 August 1977



Admiral Stansfield Turner, USN
Director of Central Intelligence
Washington, D.C. 20505

Dear Stan:

Enclosed is the 4th Report of the Military-Economic Advisory Panel. The Report both summarizes the Panel's past work and recommendations and responds to the specific questions you raised at our last meeting. I also enclose several additional copies with suggested distribution to senior officials in CIA whose responsibilities are related to the matters dealt with in the Report.

Several points covered in the Report will be amplified orally by individual members of the Panel at our August 29 meeting.

Finally, while all members of the Panel concur with the report in general and have been given the opportunity to comment on early drafts, time has not permitted them all to see the final draft. Therefore, I cannot commit each individual to every specific in the Report. Knowing the members of the Panel as I do, however, I am confident they will make any individual reservations clear at our meeting.

We look forward to seeing you on the 29th.

Warm regards,

K. Wayne Smith

Enclosure:
As Stated

100 11 1 50 10 11

EV

Confidential

**Report of the Military-Economic
Advisory Panel to:**

**Admiral Stansfield Turner
Director of Central Intelligence**

Confidential

August 1977

STAT

Approved For Release 2004/02/19 : CIA-RDP80M00165A001000270003-2

Approved For Release 2004/02/19 : CIA-RDP80M00165A001000270003-2

REPORT OF THE MILITARY-ECONOMIC ADVISORY PANEL TO

Admiral Stansfield Turner
Director of Central Intelligence

Summary of Key Points

Since its inception in 1973 the Military-Economic Advisory Panel has examined questions concerning the adequacy, utility, and validity of CIA's and the Community's work on the Soviet economy as it relates to the military power and potential of the USSR. Our early concerns stressed questions of evidence, methodology, and inter-office cooperation within CIA. Subsequently, at the direction of Director George Bush, the Panel expanded its focus to the Intelligence Community as a whole and broadened its outlook.

Responses to Panel suggestions have, on the whole, been positive and productive, particularly where we have called for incremental efforts in familiar problem areas. In other areas, particularly those involving departures from the analysts' experience or new organizational or methodological emphases, the responses have not always gone as far or as fast as we would have liked. We discuss the specifics in the body of the paper, but there are a few areas of continuing concern worth highlighting at the outset.

The central concern remains the analytical research base. With the new collection systems now available, today's analyst has more detailed data from technical sources at hand than ever before. But in the case of economic and political analysis on the USSR the same number of analysts--or fewer--are now working on this body of data and are spread more thinly over problems more worldwide in scope than fifteen years ago. There are several interrelated aspects of this problem:

--Human Capital: What are the personnel requirements for today's and tomorrow's specialized intelligence analysis problems, and whose responsibility is it to develop this essential resource? Will sufficient manpower resources be available to maintain the necessary analytical capital stock? This need should be studied with at least as much care as the justifications and specifications for new technical collection systems.

CONFIDENTIAL

- Basic Research and Interdisciplinary Analysis:
The attrition over time of basic research efforts on the Soviet Union, both in and out of government, has seriously weakened the evidentiary base of political and economic analyses in particular, and works against successful integrated analyses on longer term intelligence problems in general.
- Soviet Area Focus: A workable organizational solution to integrating specialized Soviet studies has not yet been achieved. There is a wealth of information available on purely military, technical, economic and political aspects of the USSR; there is little effort to integrate this information into more balanced assessments of Soviet motives, plans, and capabilities. Except in the purely military and technical fields, senior managers have had their attention and responsibility spread too broadly.
- Collection Priority: The relative wealth of technical collection has overshadowed collection and exploitation of human and documentary sources--particularly overt sources--with a diminution of the particular perspective often available only from those sources.

A final summary point concerns the question of intelligence in the public arena. Here, the issue that must be faced squarely is credibility. Departmental intelligence is sometimes perceived by the White House, the public, and Congress as policy-biased, and consequently viewed with distrust. In the past, CIA has had less of a credibility problem because CIA analyses were less in the public eye. The issue now, however, is no longer one of "whether" to expose CIA analyses more openly. That alternative seems to be foreclosed. The question becomes one of determining the forms and limits of exposure and of building the understanding and skills needed for dealing with the intricacies of public debate. Professional competence and objectivity must also be maintained. This will require a strong commitment on the part of the Director to be forthright when intelligence does not fully support a favored policy of any one of the consuming community.

CONFIDENTIAL

CONFIDENTIAL

DISCUSSION

I. Introduction

1. This report first sets forth a brief Panel review of its origins and activities during the four years of its existence and summarizes the principal areas of inquiry and suggestions made by the Panel to former Directors and their senior managers. Against this background, we then review the responses made by CIA and the Community to Panel recommendations and comment on issues covered by the Panel on which progress has not gone as far or been as fast as recommended. Finally, in the concluding section, we consider some matters of continuing priority concern which in our view are of sufficient importance to warrant the personal attention of the Director of Central Intelligence. These include issues raised directly with the Panel by the DCI in his May meeting with us.

2. The Panel is aware that in preparing this report it is doing so without full knowledge of ongoing planning within the Intelligence Community on organizational changes and intelligence priorities, and that some of our comments may have already been overtaken by events.

II. Origins and Early Concerns of the Panel

3. Director Richard Helms took the first steps in establishing the Panel in 1972, seeing it as an outside body of specialists that would review and report to him directly on CIA's work in military-economics, with particular reference to the USSR. The charge was to study the utility of the work to intelligence consumers, its adequacy for policy support, and its validity both factually and as a method for understanding Soviet defense policies in relation to those of the US. The membership was selected to include experts in fields bearing on these questions.

4. Thus, the Panel is a group which by charter and composition has had a special interest in intelligence on the USSR and in particular on issues of military power and potential--including the political dynamics and economic and technical resources that influence Soviet military programs. Primary attention has been directed at CIA because of its central role in this area and because of the DCI's direct

CONFIDENTIAL

management authority and responsibility for CIA. Panel findings and recommendations have been made in written form at the Confidential or unclassified level, but these have been augmented in detail orally at higher classification levels.

5. Under Directors Schlesinger and Colby the Panel reported through the Deputy Director for Intelligence, but at the urging of Deputy Secretary of Defense Robert Ellsworth, Director George Bush authorized enlargement of the Panel by two members nominated by the Department of Defense and directed that it report to the DCI in his Intelligence Community role.

6. The first Panel report concluded--among other things--that much of CIA's work was overly protected by security classification. This, we felt, deprived CIA of some potential advantages of review and acceptance (or informed and helpful challenge) by outside specialists. The Panel believed there could be greater openness without undue risk of exposure of sensitive sources and methods. The report also found that important portions of the data base on production rates and prices had been neglected for too long and that the computational model used to generate the cost matrix was inadequately documented with regard to source of information. Finally, the Panel urged that the data system be upgraded in terms of operational flexibility.

7. The report noted also that despite much effort by CIA to communicate to the consumer the complexities and pitfalls in the use of its various monetary measures of Soviet military activity, the consumer too often remained confused as to the meaning and limitations of the information and consequently often suspicious of its validity. To meet this challenge we suggested that more effort be made in style and form of presentation and that complimentary measures of military resources should be tried. For example, one persistent conceptual confusion led consumers often to regard annual resource flows as an implied measure of power relationships--which is a stock rather than a flow concept. We recommended that CIA make a direct attack on this by developing monetary measures of weapons inventories.

8. Perhaps the most important of all, the first report noted that there had been a marked decrease over the past ten years in the amount and quality of basic research on the Soviet economy, and an attrition in the number of skilled Soviet specialists available to work on the problem. We

CONFIDENTIAL

recommended more attention by senior managers to this and greater collaboration between the Office of Economic Research and Strategic Research. Although it was not spelled out in detail in the written report, we orally reported to the DDI and the Directors of OER and OSR that the ruble price base for military goods was still heavily weighted by analysis and data of the late 1950s and early 1960s and thus badly out of date. We strongly recommended greater exploitation of emigre sources and newer price handbooks and more emphasis by NSA and the DDO on collection of price data.

9. While in its first report the Panel raised a number of points critical of some of CIA's work, it also recorded an overall favorable impression of the direct costing methodology because of its close ties to the physical evidence of deployed forces and because it was the only method available that could yield data capable of being aggregated in various ways for different analytical purposes. We also felt that the quality of work in this area was, in general, both objective and professional.

10. Thus, in its first look at the problem, the Panel perceived that there was good work being done, but that there were a number of areas calling for management attention and improvement. While correctly recognizing that the price base needed some intensive work, we did not raise the possibility that the ruble prices were as seriously out of touch with Soviet "reality" as later became apparent. By the time of the second report, the increased information available and new analysis of ruble/dollar ratios, coupled with the impact of the information provided by the now famous emigre source, had made a compelling case for a significant recalculation of the ruble estimates of Soviet military programs. CIA's forthrightness in reporting its revaluations was clearly the responsible and professional course of action, even though it brought some political storms on the heads of Agency officials, caused disbelief and criticism from some consumers, and led to a great deal of distorted comment in the press. This experience dramatically confirms the Panel's early concerns regarding the critical need to keep a close eye on the basic research and information base supporting current analyses, and in particular, the ruble-dollar ratios, due to the highly sensitive role they play in the Agency's costing approach. CIA cannot afford to rely on ancient data in this area.

III. Later Panel Concerns

11. The major themes of the first Panel report recurred with varying degrees of emphasis in later Panel discussions and reports. And as the Panel became better versed in the underlying data and methodology of CIA's and the Community's work and more exposed to the prevailing concerns of consumers, subsequent reports became broader in scope and in some instances more specific in suggesting remedial action. In particular, during 1975 and 1976 the Panel:

- Reported its serious concern over the reliability of estimates of Soviet RDT&E costs and the Community's general understanding of the long run competition of the US and USSR in science and technology. A separate report devoted entirely to this subject suggested possible organizational and analytical approaches to this subject.
- Stressed the need to develop supplementary aggregative approaches to measuring Soviet military outlays through analysis of internal Soviet national income, budget, and industrial sector data as a means of keeping the ruble estimates based on direct costing calibrated against internal Soviet accounts. These "alternative methodologies" were seen as an important cross check on the direct costing approach, which has obvious and serious projection deficiencies.
- Recommended that CIA devote more attention to understanding Soviet price formation policies, including the roles played by subsidies, new goods pricing, and other aspects of pricing methods.
- Suggested that in addition to dollar/dollar comparisons of US and Soviet resources going to military purposes, that ruble/ruble comparison also be added to help understand and explain the importance of index number distortions in such comparisons. Further, it was suggested that these comparisons always be published together.
- Suggested the need to reestablish a more direct Soviet area focus with senior management to improve integrated work on political, economic, technical, and military analyses on the USSR.

CONFIDENTIAL

- Reemphasized its concern over the level of effort on basic research on Soviet policy priorities and military and economic potential.
- Restated its call for comparisons of the monetary value of major weapons inventories of the US and USSR as a way of emphasizing the importance of existing stock levels.

IV. CIA and Community Responses to Panel Suggestions

12. Overall, we have been encouraged by the extent of positive reaction to Panel recommendations, although, of course, progress has not been uniform. Our recommendations have fallen into two fairly distinct categories:

- The first is a class of suggestions that call for essentially incremental efforts where the data problems and concepts are familiar and analytical approaches well-developed.
- The second category involves recommendations that are more far-reaching and innovative, and therefore less familiar and more difficult and costly to grapple with.

13. For the most part, progress has been more positive and productive when the Agency has moved against the first class of problems--for incremental gains. For example, the basic computational model for direct costing has been significantly upgraded and is now operational. More rigorous documentation of production and price methodologies has been developed and is being machine-indexed for better access.

Improvements have been made in communicating the meaning and limitations on the use of military-economic intelligence. The cumulative effect of all such steps is, we believe, that the state of health of the estimating process and its results is improved.

14. In the case of the second class of suggestions--the admittedly more difficult arena of innovation and cross-disciplinary analysis--the record is more spotty and progress slower than we had hoped. For example:

- The DDI responded to the Panel suggestions for organizing for a more comprehensive study of Soviet science policy, resources, and potential by creating an inter-office task force across disciplinary lines, as we recommended. But at the last Panel meeting, when we were briefed on progress, we sensed less forward movement than we had expected. This is clearly a complex task, with both data and methodological problems, but it is critical for understanding the long term US/USSR power relationship. We urge more Directorate and Office level management attention in providing staffing and other support as well as analytical guidance.
- Some attention has been given to developing economic measures of forces-in-being and weapons inventories as a new and valuable additional dimension to assessments of the quantity and quality of Soviet forces. Again, however, progress has been slower than we had hoped.
- The recent sharp upward revision in ruble estimates of resources going into Soviet military programs has brought into clear focus the need for more attention to possible cross-checks or supplementary methods. While direct costing does not lend itself to projections, we believe there is no satisfactory alternative to this method for providing a detailed, structured, economic profile of Soviet military activities. Unless results of direct costing can in some way be calibrated against internal Soviet economic data, however, the potential exists for the direct-cost methodology to go badly awry again as time passes. OER and OSR must continuously update the data and this task must be given priority.
- A related problem is pricing policy. It would be of great value to increase our understanding of the Soviet price formation system in the military and civilian sectors, to determine true ruble prices, and to understand their significance in Soviet decision processes. We must know more about the roles played by subsidies, new goods pricing, and other aspects of pricing methods. This will contribute to a better understanding of the "defense burden" issue.

CONFIDENTIAL

--Progress has been slow in completing ruble valuations of US military outlays for ruble/ruble comparison of US and Soviet programs. This is a joint CIA/DoD problem and it could require considerable effort, but the results could go a long way towards establishing the extent and nature of the distortions that are inherent in the dollar/dollar comparisons standing alone.

15. In pointing to these shortfalls the Panel realizes that the managers and analysts working on the problems have not slighted them for lack of interest. The analyses called for are among the more intractable of intelligence issues and the resources available to apply to them are limited. For them to be tackled more effectively there may be--in addition to the application of more analysts--the need to reconsider the appropriateness of the present organizational framework within which they are being addressed.

V. Looking to the Future

16. The points addressed in preceding sections are persistent issues of intelligence methods that will as a matter of course require regular attention. Matters of data reliability, research emphasis, collection priorities, and reporting media are the stuff of day-to-day management of the intelligence process. We believe that periodic reviews that include some participation by outside specialists, in whatever form the DCI elects to use, will continue to be useful in searching out areas of possible neglect within this largely technical analytical framework. Such an oversight role by external audit aids both the analyst and manager.

17. Beyond those issues of detail there are also some more fundamental questions relating to intelligence planning priorities and organization and the proper role of intelligence in influencing and supporting national policy. This final section of the report will be devoted to several such broad issues--including some that were raised by the DCI at his meeting with the Panel earlier this year.

CONFIDENTIAL

CONFIDENTIAL

18. Earlier in the paper reference was made to the special interests of the Panel in the study of the USSR and its military posture. We think this emphasis wholly appropriate: the USSR is in serious, long-range, and worldwide competition with the US, with a degree of dedication and a level of resources at hand not even closely matched in any other present or potential power center hostile to US interests. And while candor calls on us to recognize that our recommendations for more attention to the USSR may be viewed as sub-optimal from the broader perspective of the DCI, we can only point to the anomaly that as the USSR has become stronger over the past ten to fifteen years, the efforts devoted to examination of some important aspects of Soviet policies and resources have been considerably reduced. Our review suggests that there is now--with regard to the USSR--a serious question of balance in the organization of intelligence and its use of resources. It is within this context of emphasis on Soviet matters that we raise and comment on a number of resources and organizational issues that have broad implications for policy at senior levels of the Agency and the Community.*

Analytical Resources

19. The basic stock of analytical talent with broad Soviet area training and experience is already low, and is likely to become alarmingly depleted by retirements over the next few years. This is so within the US Government generally, but can become particularly acute within the Intelligence Community. The strong cohort of Soviet area specialists, many with multi-disciplinary backgrounds, that was built up in the 1950s was made possible because of a substantial level of Government sponsored research at universities and research institutions, a high degree of student interest in Russian studies in the early post World War II years, and a strong demand pull stemming from employment opportunities in the field.

**The importance of military-economic intelligence to US national interests extends, of course, well beyond the realm of Soviet activity, and determination of the proper balance of resources to devote to this subject in its broadest terms would require extending the type of overviews we have undertaken on the USSR to other nations or spheres of influence to evaluate relative priorities.*

CONFIDENTIAL

20. These nourishing factors began to diminish during the 1960s, with the result that at the more junior ranks there are some serious gaps appearing in analytical breadth and depth. By this we mean not only that the number of analysts with a background in Soviet studies is low, but also that among those available, many are over-specialized by discipline and have not the breadth of training and experience to enable them to analyze effectively problems involving multi-disciplinary aspects of Soviet actions and motivations.

21. The full extent of this problem and its potential severity in the light of future needs has not been sufficiently studied. We urge that such a study be undertaken because the gestation period for fully functioning experienced talent is long and the pipeline from the universities may not be adequate to meet the needs.

Soviet Area Research: In-Depth Analysis

22. The shortcomings we see in this area are of course related to the problem outlined above, although cause and effect are not too clear. What seems at first glance to be at the heart of the difficulty the Community experiences in bringing all data and disciplines to bear on problems such as Soviet science policy, practices, and resources, or on projections of Soviet military forces and analysis of military goals--to note just two important examples--is the shortage of human capital mentioned above. Yet it can be equally argued that the demands placed on the Community--particularly CIA--to expand its substantive coverage of worldwide problems have led to a gradual reduction in the level of effort on the USSR and a shift from basic research to concentration of short term policy support. This has, over time, reduced the incentives to recruit and train people with the very talents now needed. It must also be acknowledged that the Community is not easily induced to engage in interdisciplinary studies and cannot readily accommodate to the kind of matrix organization required.

23. In any event, the Panel sees the research base necessary to accomplish serious and highly professional analysis of long term Soviet competition with the US as being in need of study and attention. This is particularly true if the DCI wants to upgrade the Community's ability to combine economic, military, technical, and political information into more balanced assessments of Soviet motives, plans, and capabilities.

CONFIDENTIAL

Soviet Area Focus

24. One method of attacking both the above issues might be to consider ways of creating a stronger Soviet area focus than now exists at senior management levels in CIA. The present situation is somewhat unbalanced. In the case of military, scientific, and technical intelligence (OSR, OSI, OWI), the Office Directors are Soviet-oriented in the major part of their management attention and in their priorities. This is not true at the Office levels for economic or political intelligence (OER and ORPA) however, where the management attention, incentives, and priorities are spread over many pressing problems worldwide in scope.

25. Compromise arrangements such as task forces, short term transfers, etc., are possible, but this approach tends to be best-suited to meet short term problems rather than some of the longer term problems of recruitment, training, and basic research planning and execution. The Panel is unanimous on the need to strengthen senior management attention on Soviet matters but is open to various approaches to how to accomplish this.

26. One option might be to combine those elements of OER and ORPA that are devoted to Soviet matters into an Office of Soviet Studies and to form a management planning board for intelligence on the USSR consisting of the Directors of that office, OSR, OSI, and OWI.

The Director's Questions

27. At the May meeting the DCI set three questions for the Panel to consider and report on when it next met with him in August. In the next few paragraphs we offer brief preliminary views on these points, based on some joint discussions we had in May. But at that meeting we agreed to give more individual thought to them during the summer, and to provide the main substance of our views orally to the DCI when he met with us in August. The three issues the Director raised were:

- The Priority of Economic Intelligence
- Collection Priority with Regard to Overt Sources of Information

CONFIDENTIAL

--The Proper Role of Intelligence in the Public
Arena

The Priority of Economic Intelligence

28. The theme that economic intelligence on the USSR--to which we added political intelligence as well--has suffered from low priority runs throughout earlier sections of this paper. The DCI's question, however, was related not just to intelligence on the USSR, but also encompassed worldwide economic issues and included commercial intelligence of interest to US industry as well as the more traditional concept of economic intelligence that impacts on US foreign trade and monetary policies.

29. Looked at from this broader perspective it is evident that economic and political intelligence generally shares a lesser priority, both in collection and analysis, compared with more purely military and technical intelligence. The high costs and admittedly high productivity of technical collection systems and exploitation of their data has weighted the balance to a substantial degree, because these systems contribute far less to economic and political analysis than to military and technical issues, yet take a very large share of all collection resources. This leaves less for collection of human and documentary source material, which is particularly important for economic and political intelligence. Also, as the focus of US intelligence has become more intense on non-Soviet matters without a commensurate increase in analytical staff, a compromise was effected that left analysis of both Soviet and other world problems inadequately supported.

30. The question of balanced priorities in these matters, and organizational forms for conducting economic and political intelligence analysis is one which deserves far more weight and attention than the Panel has been able to give it in full session. We feel that there is a need for an all-encompassing "zero-based" intelligence priorities study. Although Panel members have not studied PRM-11, we take it from brief press references that it does cover many or all of the issues we have raised, and we are hesitant to add our voice except on matters with which we have had direct experience, either individually or collectively. In one such area we provide an Appendix (Appendix 1) on economic intelligence prepared by one member, Dr. Dam, for the Murphy Commission. The Panel generally supports the views in that paper.

Collection Priorities

31. As noted above, the issues of collection and analytical priorities are inseparable at the level of discussion in this report. Most of our previous suggestions for increasing the quality and quantity of analytical effort on Soviet economic and political problems assumes some increase in collection priorities for human and documentary source materials--both overt and covert. Such collection is relatively inexpensive compared to the more technical means, but the analytical resources must be available to take advantage of it.

25X1

The Role of Intelligence in the Public Arena

33. In January 1976, we reported:

"The Panel is keenly aware of the changing environment in which the Agency must now function. . . . The Panel supports this increased openness: indeed it was called for in its First Report. At the same time,

CONFIDENTIAL

the Panel is also aware of the potential pitfalls inherent in this change. If it does not mark the beginning of the Agency's full participation in the public debate regarding national security issues, it surely marks the end of its ability to select when and how it will participate in the debate. The public arena differs in basic ways from the interagency arena in which the Agency has traditionally functioned. If it is to continue to provide objective analysis of the highest quality, its analysis and analysts must be protected from the obvious political pressures that increased participation in the public arena will bring. Both must continue to focus on what's right rather than who's right. . ."

34. That passage places central emphasis on the issues of quality of analysis and freedom to conduct objective analysis and reporting--essential ingredients to maintaining credibility in the eyes of the public and the press. Just as White House officials and Congress sometimes mistrust departmental intelligence analysis because they all too often are surfaced only when they support departmental positions, so will the public perceive CIA and Community-wide analyses if they are perceived to be a method for influencing partisan debates in support of Administration positions.

35. An important consideration of credibility, we think, lies in the context in which intelligence is released. One context is when the subject matter and methods deal with substantive issues which are of continuing broad interest and are under the regular scholarly scrutiny of specialists both in and out of government. The general status of the Soviet economy is an example. In such cases a policy of making available on a regular basis the methods and results of intelligence analysis--within reasonable constraints of security--will contribute to a better informed public understanding and will foster a healthy intellectual interchange among government and non-Government researchers.

36. The other important context concerns issues of the moment: issues that because of immediate and pressing policy considerations require special intelligence assessments that are highly focused on specific policy decision

CONFIDENTIAL

criteria, but where a public interest is also served by release of the results of analysis. The CIA energy paper is an example. In such cases we think the credibility of the intelligence analysis will be best served if release is not seen as a unilateral Intelligence Community or CIA action, and not always at the initiative of the Administration, but as a response to the urgings of either the Administration or the Congress for release of findings felt to bear importantly on a current issue.

37. Another important consideration is how new intelligence is presented and how it is released. For example, CIA's recent doubling of its ruble estimates of Soviet defense expenditures was the result primarily of revisions in its ruble-dollar ratios, rather than any significant changes in its estimates of the quality or quantity of Soviet forces. Yet, for whatever reasons, this fundamental point has been lost in media reports.

38. There are many additional considerations concerning the forms and limitations of open use of intelligence that the Panel members individually have been giving some thought to, and we think it best to provide these to the DCI as individuals at the August meeting.

VI. CIA Dollar Costing of Soviet Defense

39. There is one final question that the Panel has been asked to address--a question raised both by the NIO for Economics and the Director of Strategic Research. This is the question of the value and meaning of dollar measures, which can be subdivided into four sub-issues:

- Is dollar costing a necessary prerequisite to estimating the ruble value of Soviet defense?
- Is there an independent interest and validity to dollar values of Soviet defense?
- Should dollar comparison of Soviet and US defense spending be published?
- If so, what changes in publication content should be introduced to reduce confusion and make the estimates more useful?

CONFIDENTIAL

Approved For Release 2004/02/19 : CIA-RDP80M00165A001000270003-2

40. There is no short way to address these issues, and we have chosen to place a longer paper prepared by Panel member Dr. Becker at Appendix 2. With the exception of one point in the paper--which is appropriately noted in the text--all Panel members support the conclusions and recommendations it contains.

CONFIDENTIAL

Approved For Release 2004/02/19 : CIA-RDP80M00165A001000270003-2

Economic Intelligence and Analysis

Kenneth W. Dam
January 1975

SUMMARY

I. Economic intelligence has grown in importance over the past five years.

II. The consumer is not interested in the sources of economic information and therefore analysis must be based on facts derived from both intelligence and other sources.

III. Competition in analysis is desirable, and its costs are slight. The need to protect sensitive intelligence sources may on occasion limit the effectiveness of this competition between intelligence and other agencies.

IV. White House consumers often mistrust departmental analysis, but they appreciate the objectivity and responsiveness of the intelligence community and the quality of its work.

V. The central organizational question is whether the economic analytical resources of the CIA should be retained or whether their function should be transferred elsewhere. Five options for locating these resources, if transfer is favored, are (1) a new intelligence community organ; (2) a new agency outside the intelligence community; (3) a quasi-governmental think-tank; (4) an existing department; and (5) some other existing agency, such as the Federal Reserve Board. The conclusion reached is that none of these five options is superior to the present organization. Nevertheless, it would be desirable to create an analytical think-tank and to strengthen existing analytical staffs while retaining the CIA economic staff.

VI. The consumer has a vital role in economic intelligence and analysis. A committee of consumers for discharging that role should be maintained.

VII. Economic issues are different from national security issues and hence different working methods are appropriate and could improve the quality of analysis. In particular, more interchange between analysts in the intelligence and other agencies would be highly desirable. Several other recommendations are offered in the text.

I. The Growing Importance of Economic Intelligence.

Economic intelligence has grown in importance over the last five years. This growth is not a fad. It derives from the change in the nature of the policy issues of central concern to the President and his principal advisors.

Until five years ago foreign economic policy provided a relatively known environment against which primary national security issues could be addressed. Economics was, in the foreign sphere, a constant against which the important political and military variables could be studied. Consequently, despite important trade and aid issues, economic intelligence was mainly concerned with the Soviet and Chinese economies and was a handmaiden of national security intelligence.

Today the nation's agenda of foreign issues is different. Foreign economic policy has reached center stage. There are few constants in foreign policy, least of all the economic questions where we confront a set of issues hardly imaginable five years ago. Beginning in 1971 the monetary rules changed, and international negotiations on exchange rates, exchange market intervention and the like became important to the United States and of direct concern to the President. Today these monetary issues find an entirely new framework characterized by what is called the petrodollar problem. The forthcoming trade negotiations, while not more important than the Kennedy Round, are nonetheless more likely to be entangled in political matters. And overshadowing more traditional economic concerns for the past year has been the question of access to resources. The oil problem is in the forefront, but we cannot be certain that we will not face similar challenges in other raw materials.

These newer problems have vastly broadened the number of countries with which economic intelligence must be concerned. For example, an effort to understand the policies and intentions of the major

Arab oil production. Economic intelligence must be focused upon intentions, and not merely upon capabilities, economic intelligence must enter a sphere of inquiry where intelligence analysts have been traditionally cautious in the security and military fields.

Not only have the past five years brought economic issues to the fore, but the difficulties of economic intelligence analysis have been compounded by the interconnections between economic, political, and military questions. The Middle East oil producers provide an example. An attempt to understand the present, much less prepare for future contingencies, purely through economic analysis would obviously be useless. Political considerations shape many Arab economic measures. The military buildup financed with foreign exchange earnings from oil is a powerful factor in estimating future behavior. These political and military factors grow out of the complex history of the Middle Eastern peoples and cannot be understood by economic analysts working alone.

II. Economic Information vs. Economic Intelligence.

Although this paper is concerned with economic intelligence, that topic cannot be properly addressed without recognizing one central fact: the consumer is interested in information, not intelligence as such. Except as a matter of occasional curiosity, the consumer has no interest in the source of information. It makes no difference to him whether the source of a fact is a publication, diplomatic reporting, or intelligence operations. What he does need is the facts, the analysis, and the understanding of problems or events that will often require a blend of all three kinds of information.

The fact that information derived from intelligence sources can often make a major contribution to an overall understanding of a problem or event must condition attitudes toward the comparative advantage of various agencies in analysis. Because of the experience required to evaluate an isolated piece of information derived from intelligence sources, there may be occasions when the blending job is best done by the CIA. How often this will be the case is impossible to say. But one cannot be certain that an organizational solution which involved using the intelligence community solely for intelligence collection and daily intelligence production, leaving to other agencies of government the analytical job, might not result in an inferior product in some areas. The risk of such a result would be highest where economic and security issues intertwine, as they do for example in oil questions.

Perhaps the greatest organizational shortcoming in the intelligence community is the failure to appreciate the value of competition in analysis. No doubt intelligence collection must be highly organized, and competition in collection is wasteful, if not in fact dangerous. But the analytical task is an intellectual task. A monopoly in anyone's hands of an analytical task leads to mediocrity.

But just as there is no reason to give the intelligence community, or any part of it, a monopoly over particular analytical tasks, so too competition from the analytical resources of the intelligence community is a good thing for the other agencies of government. To take a single example, analysis by the CIA of foreign agricultural conditions, particularly in the Soviet Union, stimulated the Department of Agriculture to do a better job during the period when export controls were a central policy issue in 1973.

A central recommendation must therefore be to avoid the normal tendency in discussions of government organization. That tendency is to decide what group is best equipped to do a particular task and then to assign that task to that group alone. Where analysis of economic conditions and events is concerned, we want as many groups to be engaged as can make a contribution exceeding the costs of the analytical resources involved.

Analysis is inexpensive, and hence the costs of competition are slight. Within the intelligence community, outlays for collection dwarf those for analysis. Within the departments, analytical staffs, though growing, are still modest in size. We have not yet reached the point where we need to worry about wasting money on analysis.

In the preceding section I suggested that because of its superior ability to evaluate isolated facts derived from intelligence sources, the intelligence community might have a comparative advantage for certain analytical tasks. The way to find out how important that comparative advantage is would be to encourage competition in analysis of particular problems between the intelligence community and other Government agencies.

Nevertheless, the problem of compromising intelligence sources limits the effectiveness of this competition where sensitive intelligence sources are involved. The intelligence community will be understandably reluctant to take any chances by transmitting raw, unevaluated intelligence to other agencies. This is a particular problem because the analytical staffs of the domestic agencies (such as Treasury, Commerce, Agriculture, etc.) have little sensitivity to intelligence problems and may not always carefully follow procedures for safeguarding intelligence information. Nor should analysts for

those agencies be chosen on the basis of their experience with intelligence matters; analytical talents are too scarce to try to make analysts for domestic agencies junior intelligence officers. The consequence is that one must live with the fact that some kinds of relevant facts will not be available to the domestic agencies in the preparation of their analytical work. But imperfect competition is better than no competition at all. And the amount of this withholding of facts can be kept to a minor, and probably insignificant, amount by improved liaison procedures between the domestic agencies and the intelligence community. The development within the past two years of the intelligence staff within the Treasury may point the way to the solution of these kinds of problems.

IV. Analysis for the Executive Office of the President.

If competition is desirable, it will nonetheless be true that each agency will tend to rely most heavily on its own analysts. But there is one part of the Government that does not have its own analytical staff and that for reasons to be discussed later probably should not have its own analytical staff. That is the Executive Office of the President, including the Council on International Economic Policy (CIEP), the Office of the Special Representative for Trade Negotiations (STR), the National Security Council (NSC), and, on some issues, the Office of Management and Budget (OMB). (These Executive Office agencies will be collectively referred to hereafter as the White House.)

White House officials tend to distrust departmental analyses. They have learned through experience that such analyses tend to support the policy positions of the department. Since any international economic issue that is likely to command the ongoing interest of the White House will involve a difference of policy view among a number of departments, this distrust is serious.

In some cases the distrust is quite justified. Examples of slanted analysis, consciously calculated to support a departmental position, may be rare (though one can never be sure how rare). It is more likely that departmental analysis that conflicts with departmental policy will not reach the White House. But by far the most common factor engendering this distrust of departmental analysis is that the long-standing interests and concerns of a particular department will automatically shape the design of a research effort and the inputs to it.

White House officials consequently tend to place high value on analysis coming from the intelligence community. To them it has an objectivity that they do not expect from the departments. True objec-

tivity is no doubt intellectually impossible, and hence it may often be that White House officials simply fail to perceive the unarticulated assumptions and the predispositions underlying the product of the intelligence community (perhaps because that product is not accompanied by policy recommendations). Nonetheless, the intelligence community's work does enjoy a reputation for objectivity that means it will be read by White House officials when departmental studies will not be. In these circumstances any organizational change that had the effect of reducing the flow of analysis from the intelligence community to the White House would be a self-inflicted wound that could not be compensated for by the expansion of departmental analytical capacities.

Paralleling the reputation for objectivity is the responsiveness of the intelligence community to White House requests for information and analysis. Because White House interest is usually tied to impending policy decisions and since such decisions usually involve differences of opinion among at least two departments, the White House may not be able to rely upon one of the contending departments for prompt work on specific points. It is an unfortunate reality that in the struggle for control of policy, departments are wont to use control of information as a tool. Hence, the responsiveness of the intelligence community to requests for specific pieces of analytical work is highly valued.

Aside from objectivity and responsiveness, the quality of CIA analytical work is also valued by White House consumers. It is well known that the staff of economists in the CIA is at least equal to the staff of any of the departments.

V. The Location of the Government's Analytical Resources.

Where should the resources for the interpretation of economic intelligence and other economic information be located within the Government? Thus far three propositions have been set forth that bear on this question. The first, which is largely implicit, is that every policy department will want its own analytical staffs and this desire should be supported, not resisted. The second is that competition is a good thing in economic analysis as in economic activity. Analysis is cheap compared to intelligence collection and most other relevant variables, such as statistics collections. Attempts to allocate analytical jobs from the top of Government are counterproductive. The third proposition is that the White House often mistrusts, partly for good reason, the analytical work of the policy agencies.

If these three propositions are accepted, then the

organizational resources of the CIA should be retained (or indeed expanded) or, on the other hand, whether this function should be transferred to some new or existing institution.

The grounds for retaining the CIA staff are compelling. In the first place the staff exists. And it is of high quality. Institutions are not built in a day. Just as one cannot build a great university or research institute from scratch in a few years, so too one cannot be sure that a new governmental analytical organization could be created that would be the equal of the CIA's economic staff. The organizational planner's penchant for moving boxes around may produce results when one seeks better coordination or better policy implementation but is downright dangerous when one is dealing with intellectual tasks.

If the decision is nevertheless made to shift the analytical responsibility from the CIA (either as a result of a judgment on the merits of the question or as part of a major restructuring of the intelligence community resulting from the current public debate over the CIA), then a number of possibilities present themselves. First, a new intelligence community organ could be created, separate and distinct from agencies with a collection responsibility. Second, a new analytical agency outside the intelligence community could be created. Third, as a variant of the second, a quasi-governmental think-tank could be created for long-term analytical efforts, leaving day-to-day fact collection and intelligence production to existing agencies. Fourth, an existing department could be tasked with the job of providing analytical support for the Government in general and the White House in particular. The prime candidates for such a function would appear to be the State and Treasury Departments. Fifth, some other agency could be chosen for the analytical task. The Federal Reserve Board, with its extensive economic staff and legal independence, would be the major candidate. In the rest of this section of the paper, these five alternatives will be evaluated.

1. *A New Intelligence Community Organ.* Should a new intelligence community organ, separate and distinct from collection agencies, be created to replace the CIA economic staff? An argument could be made that such a "separation of powers" within the intelligence community would be desirable. It might be thought that such a separation would help to safeguard the citizen's liberties by diffusing the power of the intelligence community. Or it might be thought that such a separation would prevent the collectors from dominating the analysts.

On reflection, such an organizational change would be undesirable. In the first place, the intelligence community is already too fragmented. To separate analysts from collectors further would be

to make collection an end in itself. If collection is to be relevant and cost-effective, feedback from analysts to collectors should be strengthened, not weakened. And in the second place, the destruction of an existing, first-class analytical staff within the CIA in order to create a new institution does not seem wise. The result would likely be a move toward mediocrity. Of course, as would probably be the result in fact, the CIA staff could simply be moved en masse to a new organization. But if all that is involved is this kind of box-shuffling, it is difficult to see what would be accomplished. Career patterns would be distorted, and it is not clear that recruitment of new talent would be improved. One may conclude that this first option has little to commend it.

2. *A New Analytical Agency.* The second option differs from the first insofar as the new analytical agency would be outside the intelligence community. Presumably the major additional advantage would be that the new agency would be more open to the public, less parochial, and perhaps more able to recruit talent, particularly in-and-out experts from universities and from business. The location of such an agency within the Government would naturally be a question. The principal consumers would probably be within the Executive Office of the President, and hence the Executive Office would be a natural candidate for housing such an institution. An objection would naturally be raised that the Executive Office is too large, and such a new institution would tend to diminish the importance of the departments in economic policy making. A more weighty disadvantage is the one already mentioned in connection with the first option—namely, that it would be difficult to create a first-class new analytical shop from scratch. Meanwhile, the existing resources of the CIA would be dissipated.

3. *A New Think-Tank.* A variant of the second option is to create the new agency in a quasi-governmental institution. The Rand Corporation is a prototype that will convey to most people what would be involved. Such a think-tank would necessarily be involved in long-range, "big picture" analysis. Indeed, that would be its strength. A certain distance from the pressures of day-to-day issues may lead to greater objectivity and thoroughness in analysis. Moreover, such a think-tank could perhaps use experts from outside the government more effectively than could governmental agencies, particularly intelligence agencies. On the other hand, it is not clear that one can successfully separate the long-term analytical job from the day-to-day analytical job. In any case, top-level consumers will be primarily interested in short, specific pieces of analysis that are hand-tailored to immediate policy issues. The objectivity of the CIA could be du-

plicated in a think-tank, but not the responsiveness to policy officials. The work of such a think-tank might provide important background studies and certainly would be helpful to analysts doing the short-term, more directed analytical jobs. But such a think-tank could not effectively replace the CIA economic staff, even assuming a staff of equal competence could be assembled. Moreover, such a think-tank staff would have a harder time obtaining access to sensitive information collected by the intelligence community than would a regular governmental institution. The conclusion one is driven to is that a think-tank for international economic analysis would be a useful institution to supplement existing capabilities but that it could not substitute for analytical work within the Government.

4. *Tasking an Existing Department.* The analytical work of the CIA could be taken over by an existing department. Most people would place this responsibility within the State Department. Those who view foreign economic policy as more a branch of economic policy than of foreign policy would no doubt resist such a transfer and would be more likely to choose another department, probably the Treasury. However one resolved that issue, it is unlikely that White House consumers would be satisfied with either alternative. The very reasons why they mistrust departmental analysis and appreciate the responsiveness of the CIA today would lead them to be unsatisfied with this option. In short, a major improvement of State and Treasury analytical capacities would be highly desirable but would not substitute for the advantages of the CIA economic analytical staff.

5. *Reliance on the Federal Reserve Board.* An answer to the argument against location of the economic analytical function in State or Treasury might be found in selection of another agency which did not have major policy responsibilities. The Federal Reserve Board would be the natural candidate. It already has an excellent, and some would say underutilized, economic staff. The Fed has independence, both by statute and by the temperament of its staff.

Although greater use of the Fed's staff would no doubt be desirable, there are several considerations that give one pause. In the first place, it is not quite true that the Fed does not have policy responsibilities. Although the Fed subordinates itself to the Treasury (and to State) when international negotiations are involved, it has operational responsibilities in international monetary markets and maintains close relations with foreign central banks. Its top officials have strong policy views extending to the full range of economic policy issues. Its Chairman is a major protagonist in economic policy debates, both in public discussion and within the Executive Branch. Therefore, although the Fed is

independent from the Executive Branch and from the White House, it might nevertheless fail to achieve a reputation for objectivity where policy decisions turned on analysis. Moreover, its very independence could make it less responsive to the day-to-day needs of White House consumers. And there is the same question raised above as to whether the Fed staff could achieve ready access to intelligence derived from sensitive sources. Finally, it must be recognized that the Fed's staff would have to be considerably broadened, if not necessarily expanded, if it were to take on such a task. Its economic analytical capacities are directed toward financial questions, and it would no doubt have to recruit the area specialists, political analysts and other non-financial experts who are now an integral part of the CIA's analytical team.

6. *Conclusion.* By way of general conclusion, one can therefore say that each of the options would have certain advantages. But none could necessarily provide an adequate substitute for what we already have. Moreover, these advantages that would flow from upgrading the quality of analytical resources throughout the Government can and should be achieved independently of what happens to the CIA. Again, competition in analysis is a principle that could improve policy decisions. The better each of the analytical staffs is, the more effective will be this competition.

VI. The Consumer Role in Economic Intelligence and Analysis.

Over the past few years the role of the consumer—policy officials who rely on economic intelligence—has gained increasing attention within the Government. So far as departmental analysis is concerned, each department is best able to solve its own organizational problems. The problems faced by INR within the State Department are quite different from those faced by OASIA within the Treasury Department. Generalization is not only difficult but probably not worth the effort here.

The relation of the consumer, particularly the White House consumer, to the intelligence community is a more important question for present purposes. This relation is crucial because economic intelligence is not an end in itself. But the intelligence community is so large and its procedures so specialized that it is quite capable of grinding out a product that no one reads. Without feedback from consumers about the trend of policy interests, the priority of analytical tasks, and the format of publications, the intelligence community cannot do an effective, responsive job.

One solution to this problem was the creation

several years ago of the Requirements Advisory Board, a group composed of economic intelligence consumers within the White House, State, Treasury, and Commerce. These consumers, who were just below the top level of policy officials, were chosen for their closeness to the concerns of Cabinet-level officials and their familiarity with the intelligence community. The RAB's significance lay more in the availability of the individuals who composed the Board than in the Board as a collegial body. The Board, as a group, was available for advice on requirements and on priorities, but it was recognized that in the end only intelligence community professionals could draft requirements.

But the existence of a group of relatively high-level consumers who were sensitive to the problems of the intelligence community and who made themselves available for individual consultation was the chief benefit of the RAB. These individual consultations were the primary means by which the all-important feedback to the community on the relevance and utility of its product occurred. It was also the mechanism by which the intelligence community gained early warning as to changes in the direction of top-level economic policy concerns.

Such an intimate relation between consumers and the intelligence community must be constantly recreated, particularly as new officials replace their predecessors, and the RAB is in fact being transmuted into a new organization. But this kind of consumer-producer relationship is crucial to the improvement of economic intelligence, even though it cannot be created by purely organizational measures. For present purposes it is sufficient to recommend that a committee of consumers be maintained to advise the intelligence community on economic intelligence.

VII. Improvements in the Quality of Analysis.

Because of the relative novelty of the interest in economic intelligence analysis, it is perhaps inevitable that habits carried over from the national security sphere should dominate the way in which the intelligence community operates. The penchant for secrecy on the part of that community, coupled with the jealousy of the domestic departments, has tended to prevent a free interchange of information and analytical product between these two spheres of the government. Both have suffered in the process.

The fact is that for most questions information derived from intelligence sources is only a small, however important, part of the body of information from which analytical conclusions must be drawn.

In these circumstances there is no reason why CIA and departmental analysts should not freely share their research papers and meet regularly to discuss their methodology, their information, and their conclusions. Competition does not imply separateness. On the contrary, just as openness among scientists leads to scientific progress, so openness among analysts improves the quality of everyone's product.

The degree of openness achieved is partly a question of temperament but it is also shaped by departmental and CIA policies. It was not so long ago that some departments refused to make their analytical papers available to the CIA. And the clearance procedure has been known to place unwarranted restrictions on the circulation of CIA publications to departments other than the State Department.

Beyond this freer interchange of work product, some changes in the style of intelligence community papers would improve the comprehensibility and usefulness of that product to policy officials. For example, dissenting views should not be suppressed. If there are two views on a matter among analysts, that very fact is extremely important for policy officials. In military matters it may be essential to have a single agreed view of the military capabilities of a particular country, but economic policy is a different matter. An analysis produced by a committee that papered over its differences to achieve a compromise view is much less useful than a clear expression of two opposed views of a controversial subject. For the same reason, it is frequently useful to allow analysts to make heretical views known to policy officials, so long as the policy officials also know what the majority view is.

However useful a sense of the difference of analytical views may be to policy officials, it is crucial to exchanges between analysts in different agencies. For this reason one of the most welcome innovations is the growing practice of identifying the analyst for the reader so that he can, by picking up the telephone, start a dialogue with the analyst.

Other techniques to improve the quality of interchange can be borrowed from the scientific and university worlds. For example, the use of quantitative methods in Government economic analysis has lagged well behind the private sector. The use of workshops involving quantitative analysts from different agencies may provide a method for improvement. Similarly, exchange and publication of papers on methodology (which is a hallmark of the scholarly world) could improve the quality of analysis within the intelligence community.

Finally, more attention needs to be paid to institutional matters in economic intelligence analysis. Within the national security sphere, the dogma has

long been the case with capabilities, not intentions, because intentions are essentially undiscoverable. Whatever the utility of that dogma for national security questions, it has little meaning for economic matters. In monetary, trade and resource matters policy officials need to know the intentions of their counterparts in other governments. By learning as much about other governments as the informed journalist knows about the U.S. government, analysts can improve the understanding of policy officials of the views and predispositions of particular agencies and even individuals within foreign governments. It is not enough for a policy official engaged in active negotiations to be told what "Paris thinks" or what the Saudi Arabian position is on a particular issue. Those governments are as complex as our own, and it is the job of analysis to break open that complexity for the benefit of our own policy officials and negotiators.

This paper has not been concerned with economic intelligence collection. Rather the attention has been focused on the analytical product. Although a number of options for organizational change were discussed, none appears *prima facie* preferable to the present organization. Indeed, any change which involved elimination of the CIA's function would run a major risk of dissipating a valuable resource without guaranteeing the development of resources of competing quality.

The road to improved analysis rather lies in closer ties to the consumer of economic intelligence, to greater competition and interchange between analytical staffs, and in an adaptation of the nature of the working methods and of the product of the intelligence community to the special nature of economic issues.

Approved For Release 2004/02/19 : CIA-RDP80M00165A001000270003-2

THE VALUE OF DOLLAR COSTING OF SOVIET MILITARY ACTIVITIES

Dr. Abraham S. Becker
July, 1977

To assess the utility of dollar costing of Soviet defense, it is useful to distinguish between the roles of dollar costing as means and as end. As means, dollar values are compiled as a preliminary to estimates of the given magnitudes in rubles; as ends, dollar values are intended as a final computational product for analysis and policy guidance.

Dollar Values as Stepping Stone to Ruble Aggregates

In the CIA estimating procedure, if direct ruble data for any particular Soviet defense element are available, then ruble values are not determined via manipulation of dollar costs. Translation from dollars is resorted to--for procurement and O&M--when ruble prices and values are unavailable or can be estimated only within an unacceptably large error margin. Unless or until intelligence on ruble prices and values improves significantly, there is no avoiding the necessity of dollar to ruble translation for particular defense components in order to compile values of total Soviet defense in rubles. By common consent, such totals are regarded as useful data for analysis and policy guidance.

Ruble values of some aggregates may be estimated by other procedures focusing on published Soviet financial and production statistics and directed at the value of total Soviet defense (budgetary analysis) or procurement of military hardware (machinery production analysis). Estimates of these magnitudes in the past have been hampered by difficult data problems. Since the alternative procedures cannot yield disaggregated estimates that show the structure of Soviet expenditure by mission, organization or even cost element, it will be necessary to continue the direct costing approach for ruble values. However, in principle, the alternative procedures can provide valuable cross checks (particularly, the machinery production analysis with respect to procurement). The Panel has in the past urged OSR to maintain a greater level of effort in this area and takes this opportunity to repeat and underscore that recommendation.

Dollar Values as Independent Aggregates

It is generally understood that ruble values of Soviet defense are used to measure the size and rate of change of Soviet spending. Related to ruble values of aggregate output such as GNP or net material product (the Marxist counterpart), ruble-value defense yields an indication of the size of the "burden" of Soviet defense. However, dollar values of Soviet defense are less well understood and have generated considerable controversy. The primary purpose of a dollar measurement is to provide a means of U.S.-USSR comparison at a particular date and over time. However, the dollar values of Soviet defense have aroused uneasiness because the question they respond to--"what would it cost the United States to reproduce the Soviet defense effort?"--seems to many to be artificial or irrelevant to the measurement objective. Questions about the methodology of dollar costing must be distinguished from the more fundamental and logically prior issue of the utility of financial or value, as contrasted with physical-unit, comparisons of Soviet and American defense activities. The latter issue is taken up first.

Whatever type of comparison is employed, ultimate interest is in the relative effectiveness of the two national forces, the core of what has come to be known as net assessment. Direct comparisons of military effectiveness are complex, requiring the use of a variety of conflict scenarios and the evaluation of such intangible factors as morale. Such comparisons are difficult to make in principle and are additionally hampered by inadequate data. Can money-unit comparisons do better? Under the rigid conditions of an optimizing mathematical model, effectiveness might be judged in terms of values of military security purchased. In such a model, decisionmakers may be pictured as making choices between alternative bundles of goods and services such that military security varies directly with expenditure. But the model assumptions about decisionmaking behavior, the nature of markets and prices, and the calculability of military security benefits associated with particular defense goods and services are abstractions far removed from the real world. Additional problems are posed by elements of arbitrariness in the Soviet price system and the related doubts about the role of prices in Soviet defense decision-making. This does not mean that there is no connection between military security and expenditure in either country, but the connections are surely not close enough to make expenditure a reliable proxy index of military security.

It seems impossible to calculate military expenditure so that it accurately reflects military *outputs* (security), but it is possible to derive value measures of military *inputs*--i.e., the flow of military goods and services (men, materials, equipment, etc.) into the military sector, whose task it is to combine these goods and services in forms that yield military utilities. The sole requirement is that the prices used to weight the physical units of goods and services reflect real costs. Assuming that U.S. dollar prices satisfy that condition, a dollar valuation of the annual Soviet military effort may be juxtaposed to the comparable U.S. figure to provide a measure of the *comparative size of the annual flow of inputs into the military sector*. Clearly, this is not a measure of comparative additions to overall military effectiveness, but it is a useful--if limited--measure on its own.

The Index Number Problem and the Need for Ruble Price Comparisons

The dollar-cost measure just described is one of two measures of comparative input flow that may be obtained; the other is a counterpart valuation of physical inputs of both countries at ruble prices. The two measures will inevitably yield different results, since relative prices, the weights of the measures, differ between the two countries. Ignoring the issue of the correspondence of ruble prices to real costs (since various adjustments could be made to the raw data to establish closer correspondence) and the empirical problems of valuing U.S. activities in rubles, it must be recognized that the two measures have equal validity and legitimacy. They also constitute equally distorted prisms for the comparison, since each set of prices reflects the particular cost relationships of the given country, which are alien to the other. If actually applied in the other country, cost relationships of the given country would surely alter decisionmakers' choices on combinations of military goods and services. Nevertheless, these are the only measures of comparative size of the annual flow that we can obtain.

Because the two measures are in principle equally legitimate and distorted, both are necessary. Each applies a particular country's yardstick--its relative prices--to the physical volumes of goods and services observed. Since the two measures inevitably diverge, it is possible that they will show contradictory directions of difference in comparative size. Only if both measures show the same direction of difference is there an unambiguous indication of which annual flow is the larger.

What to Publish and How

In recent years, increasing attention has been focused on CIA estimates of Soviet defense. Unfortunately, the estimates have often been misunderstood and, as a consequence, misused. Part of the difficulty has been caused by lack of comprehension of the estimating process itself. In addition, there has been confusion over the meaning and uses of ruble and dollar valuations of Soviet defense. It appears to have been particularly difficult for users to resist the temptation to think of the dollar figures as estimates of Soviet "spending" or of the size of the Soviet "effort", whereas such categories can only be approached in ruble terms.

In view of these problems, the Panel offers the following suggested guidelines for publication:

1. Absolute dollar values of Soviet defense should not be released in CIA publications at any level of classification.* With respect to comparative standings at a particular date, all the necessary and useful information can be conveyed in the form of U.S.-USSR ratios. If ruble comparisons of the two sides were available, interest would surely attach to the ratios rather than to the absolute size of U.S. defense in rubles. The utility of dollar values of Soviet defense in a time series is even less apparent. Relative military efficiency is only indirectly related to comparative expenditure, but the relation is weakest at a particular date and makes more sense over a long interval. Thus, analytical value attaches to the index numbers and not to the absolute values of a time series. Enterprising readers may be able to calculate the absolute Soviet dollar figures from known U.S. figures, but since CIA uses FYDP obligational authority data, this exercise would not be easily accomplished and would discourage the ordinary user. Less scrupulous or knowledgeable users may derive absolute values in other ways. This should not be a major source of concern: it is obviously impossible to guarantee against any misuse of data or even analysis, and the Agency's explicit caveats will be plainly marked to help keep the record clear.

-4-

*Some panel members do not believe it feasible or politic for CIA to stop publishing absolute dollar figures at this time. This matter will be discussed more fully at the August Panel meeting.

2. CIA should continue to work on ruble values of U.S. defense in order to publish ruble-based U.S.-USSR ratios and indexes of change simultaneously with the dollar-based magnitudes discussed just above. Ruble-based measures are a necessary adjunct to the dollar-based comparisons in principle. In addition, the simultaneous publication of ruble-based and dollar-based ratios and indexes will help the user understand some of the basic theoretical issues and avoid misuse of the estimates.

3. Comparisons of relative size of the components of the US and Soviet defense activities provide useful insights for threat perception, and should be made in both rubles and dollars. Such component sizing measures, however, are not relevant to questions concerning the relative priorities, motivations, or structure of defense expenditures in the country whose currency is not being used in a given calculation. What proportion of its defense resources the USSR allocates to strategic offense or defense cannot be understood in dollars, just as a Kremlin study of how DoD distributes its defense budget relative to the USSR would be foolish to insist on ruble valuation, even apart from the deficiencies of the Soviet price system.

4. Over and above the ratios, indexes, and structural measures, intended to provide a basis for U.S.-USSR comparisons, there will be a continued need for measures of the level and trend of the Soviet defense burden. These should continue to be calculated in rubles.

5. To the extent possible, all the measures discussed under 1-4 should be published between the same covers. The juxtaposition of particular measures with particular analytical questions should improve understanding of the function and meaning of the various measures.

Confidential

Confidential

STAT

Approved For Release 2004/02/19 : CIA-RDP80M00165A001000270003-2

Approved For Release 2004/02/19 : CIA-RDP80M00165A001000270003-2